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AGENDA ITEM 3d

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** United Nations Principles for Responsible Investment
– Update
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

Executive Summary

In April 2006 at the direction of the Investment Committee, CalPERS became one of the original signatories of the Principles for Responsible Investment (“PRI” or “Principles”), which CalPERS helped develop. This agenda item updates the Investment Committee on CalPERS’ involvement with the PRI and how CalPERS incorporates the Principles, consistent with its fiduciary duty.

Background

In early 2005, CalPERS was invited by the United Nations Secretary-General to join an investor working group to develop a set of global best-practice principles for responsible investment. The investor working group consisted of 20 institutional investors, including CalPERS, from 12 countries and was supported by a 70 person multi-stakeholder group of experts from the investment industry, intergovernmental and governmental organizations, civil society and academia. The group’s efforts, which were coordinated by the United Nations Environment Programme Finance Initiative (UNEP FI) and the UN Global Compact, resulted in the development of the Principles for Responsible Investment.

On March 13, 2006, the CalPERS Investment Committee voted to become one of the original signatories of the PRI. The Principles were officially launched at a signing ceremony at the New York Stock Exchange on April 27, 2006 during which 32 institutional investors (including CalPERS), representing over \$2 trillion in assets under management, formally signed the Principles.

By signing the Principles, CalPERS publicly committed to adopt and implement them, where consistent with its fiduciary responsibilities. A copy of the Principles is provided as Attachment 1.

This agenda item updates the Investment Committee on CalPERS' involvement with the PRI and how CalPERS incorporates the Principles.

Update

UN PRI Board

CalPERS is represented on the UN PRI Board by Interim Chief Investment Officer Anne Stausboll. The Board consists of eleven members and oversees the work of the PRI Secretariat.

Global Adoption of the Principles for Responsible Investment

When the PRI was originally launched in April 2006, there were 32 institutional investors representing over \$2 trillion in assets under management. As of May 2008, there were over 350 signatories representing over \$14 trillion in assets under management: 134 asset owners, 156 investment managers and 74 professional service partners. The global support of the PRI has continued to grow as the PRI Board, Secretariat, and signatories continue to promote adoption of the Principles. As evidence of the growing support, the Principles have recently been translated into Russian.

Clearinghouse

To assist with the collaboration among signatories, the Secretariat created a 'members only' clearinghouse webpage on the PRI website. The goal of the clearinghouse is to provide signatories with a simple way of sharing information and collaborative opportunities as well as to, in time, become a valuable repository for resources on engagement.

CalPERS has submitted numerous postings to the clearinghouse over the past year describing CalPERS' efforts with regard to proxy voting, support of shareowner proposals and most recently the revisions to the Global Principles of Accountability for Corporate Governance. CalPERS also posted an invitation to sign on to the Investor Network on Climate Risk's Action Plan. The Action Plan

will help boost investments in energy efficiency and clean energy technologies and require tougher scrutiny of carbon-intensive investments that may pose long-term financial risks.

Staff also reviews postings from other signatories for potential opportunities to collaborate with like-minded investors on issues important to CalPERS.

UN PRI Working Groups

CalPERS is involved with several PRI working groups that consist of fellow signatories and members of PRI. Laurie Weir, Portfolio Manager, Real Estate has participated in a group that will put out a document entitled, "Property Assets and the Principles for Responsible Investment: Guidance from practice." The document, which will be presented at the June 18th annual PRI meeting in Seoul, outlines some of the areas in which Real Estate is applying the principles in their investment practices. CalPERS has contributed information on our California Urban Real Estate program, Responsible Contracting, and "green consultants."

Bill McGrew, Portfolio Manager in Corporate Governance represents CalPERS on the *PRI in Emerging Markets Project* ("EM Project"). This group brings together PRI members from many different countries to discuss how Environmental, Social, and Governance (ESG) issues influence their finance, investment and business practices, while also providing key updates on regional news and activities.

And finally, our AIM group has been participating in a working group on private equity. This group is still in the beginning phases.

Incorporating the Principles at CalPERS

The Principles are consistent with CalPERS corporate governance and other shareowners' efforts that have been underway since 1984. The Principles are voluntary in nature: signatories are not required to address each one. The following section provides examples of how CalPERS is incorporating each of the six Principles, consistent with its fiduciary duty.

Principle 1. We will incorporate ESG issues into investment analysis and decision-making processes:

Global Equity:

- In September 2007, CalPERS and 21 other co-petitioners submitted two requests to the U.S. Securities and Exchange Commission to 1) clarify that material climate-related information must be included in corporate disclosures and 2) request the Division of Corporation Finance devote

particular attention to the adequacy, under existing regulations, of disclosures concerning climate risk.

- In October, 2007, CIO, Russell Read testified to the Senate Subcommittee on Securities, Insurance, and Investment hearing on “Climate Disclosure: Measuring Financial Risks and Opportunities.”
- The Global Principles of Accountable Corporate Governance incorporate ESG issues and provide the foundation for supporting CalPERS’ corporate engagement and governance initiatives.
- Statement of Investment Policy for Corporate Governance Investments: Applies on a global basis covering both developed and emerging markets. In all instances where an Advisory Board is present at a Corporate Governance Fund in which CalPERS has an investment, CalPERS will seek membership in order to provide oversight and counsel regarding the Corporate Governance Fund’s operational, investment, and corporate governance activities.
- Focus List Program: The list adds value to the fund by identifying underperforming companies with inferior governance practices and effecting positive change through direct engagement.
- Environmental Company Engagement Program: Targets companies in the airline, auto, utilities, and oil and gas industries that are underperforming relative to their industry peers and lack disclosure on the four elements highlighted in the Global Framework for Climate Risk Disclosure. Companies selected for engagement are requested to apply the Global Framework for Climate Risk Disclosure in their reporting process.
- Environmental Equity Investment Managers: The CalPERS’ external environmental equity investment managers apply an environmental screen when selecting stocks for their portfolios.
- Emerging Equity Markets Principles: The principles present factors, such as promoting corporate social responsibility and long- term sustainability, which managers should use when evaluating investments in emerging markets.
- Survey of Public Equity Investment Managers: In conjunction with INCR, survey managers regarding their ability to evaluate climate risks and opportunities of the companies in which they invest.

Alternative Investment Management:

- Environmental Technology Program: CalPERS has committed \$600 million to date to its diversified portfolio which includes renewable energy and water technologies.
- CalPERS California Initiative: With over \$900 million in commitments, the California Initiative is designed to invest in traditionally underserved markets, primarily in California.
- The Statement of Investment Policy for Restricting AIM Investments in Public Sector Outsourcers: The strategic objective is to restrict private equity investments in entities that are likely to outsource U.S. state and local public sector jobs because of the potential negative impact to the employees and members of CalPERS.
- Environmental Impact and Reporting – The process tracks the aggregate environmental benefits being created by our private equity investments in the Clean Energy & Technology sector on an annual basis.

Real Estate:

- Energy Efficiency Plan: This plan was adopted in December 2004, with a goal of reaching a five-year energy reduction of twenty percent in CalPERS' core Real Estate portfolio.
- The Statement of Investment Policy for Responsible Contractor Program: This policy was adopted by CalPERS in 2005. The policy supports and encourages fair wages and benefits for workers, subject to fiduciary principles concerning duties of loyalty and prudence, which further require competitive returns on CalPERS' real estate investments. This policy has been used as a model for establishing responsible contractor practices throughout the industry.
- California Urban Real Estate Program: CalPERS has made a commitment of approximately \$4.8 billion to the CURE program to date. CURE investments include, but are not limited to, low-to-moderate-income housing, multi-family low-income housing, commercial or residential or both, urban infill, community redevelopment, and rehabilitation of core properties.
- Green Fund: CalPERS has made a \$225 million investment with the Hines Group to invest in certified green buildings.

Inflation-Linked:

- Forestland Policy: The policy sets a strong foundation for sustainable forest management practices within the portfolio.
- Pending Infrastructure Policy: The policy represents the collaborative efforts of stakeholders to achieve the proper flexibility to successfully implement the program while maintaining CalPERS objectives and goals, supporting and encouraging competitive bidding, and providing protections for the interest of public sector employees.

Principle 2. We will be active owners and incorporate ESG issues into our ownership policies and practices:

- Proxy Voting: CalPERS votes over 7,000 global proxies each year in accordance with its Statement of Investment Policy for Global Proxy Voting and the Global Principles for Accountable Corporate Governance.
- Company Engagement: Staff conducts company engagement on ESG issues both privately and publicly, as well as individually and collaboratively. Some examples of ESG issues that staff engage companies on include:
 - Proxy Access
 - Majority Vote for Directors
 - Pay for Performance
 - Environmental/Climate Change
 - Human Rights Issues, e.g. Sudan, Iran, Holocaust victims
- File Shareowner Resolutions: Staff routinely files shareowner resolutions at portfolio companies on ESG issues. Recent shareowner resolutions include:
 - Proxy Access
 - Board Declassification
 - Remove Supermajority Voting Requirements
 - Director Elections by Majority Vote
 - Executive Compensation Advisory Vote

Principle 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest:

- CalPERS routinely encourages its portfolio companies via correspondence, direct dialogue, or by supporting shareowner resolutions to disclose on ESG issues. Some examples of reporting standards that staff have encouraged companies to adopt in their annual reporting process include:
 - The Global Framework for Climate Risk Disclosure: CalPERS helped draft the Global Framework, which encourages standardized climate risk disclosure to make it easy for companies to provide and for investors to analyze and compare companies.
 - The Global Reporting Initiative Sustainability Reporting Guidelines: Reporting mechanism by which companies can disclose their ESG performance.
 - The Carbon Disclosure Project: CalPERS is a member and signatory – an annual questionnaire is sent to companies on behalf of institutional investors requesting information on the business implications of climate change and the companies' greenhouse gas emissions.
 - In addition, our Global Principles of Accountable Corporate Governance urge companies to advance corporate governance dialogue while also providing an educational forum by representing a foundation for accountability between a corporation's management and its owners.

Principle 4. We will promote acceptance and implementation of the Principles within the investment industry:

- Corporate Governance Investment Funds: CalPERS will seek membership on Advisory Boards whenever available and will make every effort to apply the Principles.
- CalPERS routinely engages the SEC and other regulatory bodies, federal and state legislators and standards boards such as PCAOB and FASB on ESG issues. Examples of issues include proxy access, executive pay, environmental disclosure, auditor independence and internal controls.
 - Written and verbal testimony to US Treasury Department Advisory Committee on the Auditing Profession (ACAP) – CalPERS provided testimony on February 4, 2008 on the sustainability of the auditing profession.

- Written and verbal testimony to SEC Advisory Committee on Improvements to Financial Reporting (CIFR) – CalPERS testified on March 13, 2008 reporting its perspective on the Audit Process and Compliance, Financial Restatements, Materiality of Errors and Professional Judgment.

Principle 5. We will work together to enhance our effectiveness in implementing the Principles:

- PRI clearinghouse: Staff utilizes the PRI clearinghouse to post issues of importance for CalPERS for which we are seeking support, and to review postings from other signatories to determine our interest in collaborating on the proposed issues. For example, CalPERS has made available translated versions of our Global Principles in Chinese, Spanish, and Portuguese through the Clearinghouse.
- Industry associations and collaborative engagement initiatives: CalPERS is either a member of or participates in the following industry associations and collaborative engagement initiatives to address ESG issues:
 - Asian Corporate Governance Association (ACGA)
 - Carbon Disclosure Project (CDP)
 - Council of Institutional Investors (CII)
 - Extractive Industries Transparency Initiative (EITI)
 - Financial Accounting Standards Board (FASB): User Advisory Group Member
 - Global International Governance Network (GIGN)
 - International Corporate Governance Network (ICGN)
 - Investor Network on Climate Risk (INCR)
 - Public Company Accounting Oversight Board (PCAOB): Standing Advisory Group Member
 - United Nations Environmental Program Finance Initiative (UNEPFI)

Principle 6. We will each report on our activities and progress towards implementing the Principles:

- CalPERS website: CalPERS regularly reports on its activities and progress towards implementing ESG issues. Often, the information is presented to the CalPERS Investment Committee via agenda items, which are available for download on the CalPERS On-Line website (www.calpers.ca.gov), or it may be posted directly to the CalPERS On-Line website or the CalPERS Shareowner Forum webpage (<http://www.calpers-governance.org/forumhome.asp>).

- Staff will continue to provide an annual update to the Board on CalPERS' activities and progress in implementing the Principles.
- CalPERS speaks at numerous conferences and events on ESG issues. For example, on May 14, 2008, CalPERS presented on the pension system's investment/corporate governance practices in emerging markets at the PRI Signatory Workshop "An Evening with Principles for Responsible Investment." Dennis Johnson, Senior Portfolio Manager, Corporate Governance, will be on a panel entitled, "Are so-called 'best practices' in responsible investment relevant and applicable to companies operating in Asia?" at the PRI Annual Event in Seoul, Korea in June, 2008.

V. STRATEGIC PLAN:

The item is consistent with the Strategic Plan: Goal I, Exercise global leadership to ensure the sustainability of CalPERS' pension and health benefit systems; and Goal IX, Achieve long-term, sustainable risk adjusted returns.

VI. RESULTS/COSTS:

The costs associated with this item are minimal as they are already absorbed by other ongoing CalPERS investment programs.

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